Office of the Legislative Auditor

State of Montana

Report to the Legislature

June 1994

Performance Audit Report

Water Development and Renewable Resource Development Programs

Department of Natural Resources and Conservation

This report contains recommendations for improvement to program operations. The recommendations address:

- Monitoring projects.
- Improvements in the administration of the Water Development Private Loan Program.
- Improvement of management controls.

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PERFORMANCE AUDITS

Performance audits conducted by the Office of the Legislative Auditor are designed to assess state government operations. From the audit work, a determination is made as to whether agencies and programs are accomplishing their purposes, and whether they can do so with greater efficiency and economy. In performing the audit work, the audit staff uses audit standards set forth by the United States General Accounting Office.

Members of the performance audit staff hold degrees in disciplines appropriate to the audit process. Areas of expertise include business and public administration, statistics, economics, computer science, communications, and engineering.

Performance audits are performed at the request of the Legislative Audit Committee which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of four members of the Senate and four members of the House of Representatives.

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June 1994

The Legislative Audit Committee
of the Montana State Legislature:

This is our performance audit of the Water Development and Renewable Resource Development Programs administered by the Resource Development Bureau, Department of Natural Resources and Conservation.

This report contains recommendations addressing program administration. We reviewed evaluation of project applications, project monitoring, and documentation of information for public grants and loans and private loans. We also reviewed selected bureau management controls related to staffing, training, and performance appraisals. We compared the Treasure State Endowment Program to the Water Development and Renewable Resources Development Programs for similarities or overlap in programs. Department responses are contained at the end of the report.

We wish to express our appreciation to the staff of the department for their cooperation and assistance.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

Office of the Legislative Auditor

Performance Audit

Water Development and Renewable Resource Development Programs

Department of Natural Resources and Conservation

Members of the audit staff involved in this audit were Susan Jensen, Charles Nemec, and Mary Zednick.

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Report Summary

Introduction

Prior to the 1993 Legislative Session, the Legislative Audit Committee requested a performance audit of the Water Development Program, administered by the Resource Development Bureau, Department of Natural Resources and Conservation (DNRC). During the 1993 session, the legislature combined the Water Development Program and the Renewable Resource Development Program into the Renewable Resource Grant and Loan Program. Due to the change in programs, we reviewed both the Water Development and Renewable Resource Development Programs during this performance audit.

Program Description

The Water Development (WD) Program was established by the legislature in 1981 to promote and advance the beneficial use of water. Private and public/governmental entities were eligible to apply for loans and grants. Public entities could apply for grants for up to $100,000, small loans (up to $200,000), or large loans (over $200,000). Entities could apply for both a loan and a grant.

The Renewable Resource Development (RRD) Program was established by the legislature in 1975 to develop renewable natural resources. Only public/governmental entities were eligible to apply for loans and grants under this program. Loans could be issued for up to $200,000 and grants up to $100,000. An entity could apply for both a loan and a grant. A water-related RRD project could also be evaluated under the WD Program, but a grant or loan would only be awarded under one program or the other, not both.

Types of projects funded under the programs included:

- Streambank stabilization.
- Reforestation of state land.
- Planning, improvements, and construction of water and sewer systems.
- Technical assistance and training for rural water system owners and operators.

Studies were also funded under the two programs. Funded studies included monitoring agriculture chemicals in ground-

water, hydrogeologic evaluations, and movement of nitrates into groundwater.

The objectives of the Renewable Resource Grant and Loan (RRG&L) Program are to ". . . enhance Montana's renewable resources through projects that measurably conserve, develop, manage, or preserve resources" (section 85-1-602(1), MCA). Developments made by the program may not significantly diminish the quality of existing public resources, such as land, air, fish, wildlife, and recreation opportunities. Private applicants continue to be eligible for grants and loans for water-related projects under the RRG&L Program. Public/government entities are also still eligible for funding under the new program. Grants can be made up to $100,000 and loans can be made for up to $200,000 (small loans), or more than $200,000 (large loans).

Program Accomplishments

For fiscal years 1984-85 through 1994-95, 282 public projects were appropriated $23,076,005 in grant funding. From fiscal year 1984-85 through April 18, 1994, 175 projects contracted for $10,544,660 of public grants. An additional 24 projects had not yet contracted with DNRC for the grant money appropriated them by the legislature. Eleven emergency grant projects contracted for $191,281 from fiscal year 1988-89 through April 18, 1994. From fiscal year 1981-82 through 1992-93, $6,576,682 was issued for 97 private loans.

The process established for reviewing public applications has improved since the program first started. The review of applications for projects submitted to the 1993 Legislature was well documented and organized. The people who evaluated the applications indicted they were given enough information for the evaluation and the information was appropriate. We also found the process used when ranking public projects reduces project scoring inconsistencies.

Public Grants and Loans

One of the objectives of this audit was to determine if the application review process for public grants and loans ranks projects based upon established criteria. The following sections discusses the audit work completed and our findings.

Review Questions Should Match the Application

During the audit we compared the loan/grant application form to the questions reviewers use to evaluate public projects. We found not all questions used by reviewers (such as requirements for long term funding, future funding sources for long term projects, or coordination of planning with other agencies) were in the application. The department has subsequently changed the application form to include all the questions reviewers consider when evaluating applications.

Basis for Grant Funding Recommendations Needed

Resource Development Bureau staff indicated they do not analyze an applicant's debt structure when determining the amount to recommend for a grant; they follow the $50,000 or $100,000 limits established by policy when the programs were created in 1981. For example, two towns with essentially the same type of project were both recommended for grants of $50,000. The project cost to the first town was about six times greater than the second town's cost. Although the first town could not afford to finance as large a loan (thus a need for more grant funding) as the second town, the grant amounts recommended were the same for both towns. The limits are based upon past DNRC recommendations and Long Range Planning Subcommittee actions. (The subcommittee makes recommendations to the legislature as to which projects to fund and the amount of funding each project should receive.) We recommend the Resource Development Bureau reevaluate the dollar limits for Renewable Resource Grant and Loan Program grants and recommend changes in the limits, if necessary, to the Long Range Planning Subcommittee.

Director Approval Needed for In-house Applications

The director of DNRC can delete projects or change the recommended funding and ranking for projects. We found projects proposed by other bureaus in DNRC were deleted by the director. However, Resource Development Bureau staff time was used to evaluate and rank projects before the director was aware the projects were proposed. We recommend in-house proposals for Renewable Resource Grant and Loan Program grants receive director approval before completion and submission of applications to the Resource Development Bureau for evaluation.

Monitoring of Public Grant and Loan Projects

Another audit objective was to determine if public projects are monitored and if the monitoring is sufficient to ensure projects meet desired objectives. The following sections describe our findings.

Limited Documentation in Files

We reviewed files to confirm information provided by bureau staff concerning monitoring of public projects. We identified three areas where monitoring could be improved: 1) documenting contacts with project sponsors including visits to funded projects, 2) comparing initial objectives with actual project accomplishments in final reports submitted by project sponsors, and 3) documenting staff review of final project reports to evaluate the accomplishments or success of projects and the program. We recommend the Resource Development Bureau improve monitoring of projects by: 1) documenting decisions and conversations that affect on-going projects, 2) including the requirement to compare proposed objectives to actual project accomplishments in the final report, and 3) formally reviewing and evaluating final reports.

Distributing Final Reports for Public Use

We reviewed bureau procedures for distributing final reports for public use. We found the bureau has not established a mechanism for DNRC to disseminate the information from projects which result in a report or study. Under the state depository law, each state agency must deposit at least four copies of each of its state publications with the State Library.

We recommend the bureau inform potential applicants that final reports are available from the bureau and reports or studies are available from the State Documents Depository Program, State Library. Grant/loan recipients should send four copies of a report or study to the State Documents Repository Program.

Private Loan Program Administration

Our objective for reviewing the Private Loan Program was to determine whether completed projects meet desired objectives. Our findings are discussed below.

Not all Financial Information Used

We found Private Loan Program staff do not use all the required or useful financial information when determining the financial status of an applicant. Staff gather information that is not used, and do not gather some information that could be useful. We recommend the bureau adopt a formal policy identifying what financial information to collect and use to determine financial status of an applicant, and implement written procedures to evaluate loan applications using the financial information gathered.

Visits to Projects are not Documented

We reviewed files of 15 private projects issued loans and found no documentation of bureau visits to determine the status of projects. However, there were travel expense vouchers indicating trips were made to the area of the project. Procedures were changed so bureau staff are now documenting the results of on-site visits to projects funded with Private Loan Program funds.

Documentation of Reasons for Dismissing Late Fees Needed

The reasoning for dismissal of late fees on loan payments is not documented. Some late fees were dismissed but there was no information in files to indicate why the fee was dismissed. There was no indication in the file that management approved the dismissal of any fees. We recommend the bureau develop policies, procedures, and documentation requirements for the assessment or waiver of late fees, including management approval of the dismissal.

Loans are not Monitored After Issuance

Our file review showed bureau staff do not monitor loans, or follow up on the financial position of the applicant, after the loan is made. The bureau does not need to obtain annual financial statements from every borrower, but should monitor those borrowers who are not able to make timely payments. <u>The bureau has subsequently changed the boilerplate language for the Private Loan Repayment Agreement to indicate a borrower delinquent in payments in excess of 30 days may be required to submit annual financial statements to the department for three years.</u>

Documentation of Loan Information and Review of Project Success Needed

File review also showed limited documentation of telephone conversations with applicants or their credit references. We also found staff do not determine if completed projects meet the purpose as specified by law which is to measurably conserve, manage, develop, and conserve Montana's natural resources. <u>We recommend the bureau improve documentation of information leading to decisions concerning private loans and the bureau should collect information to help determine if the program is meeting statutory intent.</u>

Program Officer Authority

A majority of the authority to make decisions pertaining to the Private Loan Program is concentrated in one person. Little or no supporting documentation is presented with the person's recommendation to management to approve a loan. No one reviews the decision to deny a loan. The program officer does provide management with periodic reports indicating the status of problem loans (those borrowers who are having difficulties making timely payments). However, the reports are not issued at established time frames. <u>We recommend the bureau establish a loan committee to review approval or denial recommendations for private loans, and establish procedures for the program officer and bureau management to meet on a scheduled basis to discuss loans.</u>

Coordination of Programs

We compared the Treasure State Endowment Program (TSEP) to the WD and RRD Programs for similarities or overlap in programs. The TSEP was created in 1992 to help local governments fund infrastructure problems. Water, sewer, and solid waste projects were eligible for funding under all the programs. During the 1993 session, staff from DNRC and the Department of Commerce (which administers TSEP) coordinated with each other when eight sponsors of projects applied for both TSEP and WD and RRD funds. The directors of the Department of Natural Resources and Conservation and Department of Commerce are coordinating activities in areas common to both programs.

Management Controls

We interviewed bureau staff and reviewed personnel files to determine if selected management controls related to staffing, training, and performance appraisals were in place and effective. We found five areas where controls could be improved: 1) goals and objectives should be written which provide a direction for action, 2) formal policies and procedures should be created, 3) position descriptions should be updated, 4) annual performance appraisals as required by state law should be completed, and 5) organized training programs should be established. We recommend the bureau improve management controls by implementing the above controls.

Chapter I
Introduction

Introduction

Prior to the 1993 Legislative Session, the Legislative Audit Committee requested a performance audit of the Water Development Program, administered by the Resource Development Bureau, Department of Natural Resources and Conservation (DNRC). During the 1993 session, the legislature combined the Water Development Program and the Renewable Resource Development Program into the Renewable Resource Grant and Loan Program. Due to the change in programs, we reviewed both the Water Development and Renewable Resource Development Programs during this performance audit.

The Water Development Program provided grant and loan money for projects which promoted and advanced the beneficial use of water. The Renewable Resource Development Program provided grant and loan money to develop renewable natural resources. Types of projects funded under the programs included, but were not limited to:

-- Streambank stabilization.
-- Reforestation of public land.
-- Planning, improvements, and construction of water and sewer systems.
-- Technical assistance and training to rural water system owners and operators.

Studies were also funded under the two programs. Funded studies included monitoring agriculture chemicals in ground-water, hydrogeologic evaluations, and movement of nitrates into groundwater.

Audit Objectives

The objectives of this performance audit of the Water Development (WD) Program and Renewable Resource Development (RRD) Program were to determine:

1. The intent of the WD and RRD Programs and the new combined Renewable Resource Grant and Loan Program.

2. Whether the application review process for public grants and loans ranks projects based upon established criteria.

3. Whether the bureau gathers required documentation from project sponsors.

4. Whether public projects are monitored and if the monitoring is sufficient to ensure projects meet desired objectives.

5. Whether a process for granting money for emergency projects is established; and whether these projects are monitored to ensure they meet desired objectives.

6. Whether procedures followed for private loans ensure projects are solicited, and completed projects meet desired objectives.

7. Whether selected management controls for the programs are in place and effective.

Audit Scope and Methodology

We reviewed legislative committee meeting minutes to determine legislative intent for the WD and the RRD Programs. We also attended legislative committee meetings during the 1993 session to determine what the legislature sees as the intent of Montana's Renewable Resource Grant and Loan Program.

Information concerning the Treasure State Endowment Program (TSEP) was gathered. TSEP was created in June 1992 by the voters of Montana. The purpose of the program is to provide funds to local governments for public facility projects. We compared TSEP to the WD and RRD Programs for similarities or overlap in programs.

We reviewed criteria used to evaluate projects. We examined processes followed when staff evaluate public grant and loan applications. We confirmed projects were ranked based upon established criteria. We interviewed reviewers to determine if they received sufficient training and information to evaluate applications. We then reviewed files for consistency of scoring between reviewers. We also compared the actual cost of reviewing applications to the application fee.

We reviewed grant and loan files to determine if the bureau is ensuring compliance with administrative rules and department

policy concerning submission and documentation of project information. We interviewed bureau staff to understand the monitoring process and to determine if monitoring is sufficient to ensure projects meet desired objectives. We then reviewed files to confirm information provided by bureau staff. Project sponsors were contacted to ascertain if projects met objectives as stated in applications.

We interviewed bureau staff and reviewed files to document the process used for granting money for emergency projects. We also reviewed files to determine if these projects are monitored to verify they meet desired objectives.

Through interviews with bureau staff and review of files, we gathered information to determine number of private loans made, dollar amount of loans, and dollar amount of defaulted loans. We interviewed bureau staff to determine procedures followed for all aspects of the Private Loan Program. We compared procedures described to us with written procedures and staff position descriptions. We reviewed files to confirm procedures described by bureau staff were followed. Areas of review included solicitation of applications, criteria used to evaluate financial resources of project sponsors, follow-up of projects, and monitoring of projects after completion. We determined procedures followed by DNRC when a borrower may default on a private loan.

We interviewed bureau staff and reviewed personnel files to determine if selected management controls related to staffing, training, and performance appraisals are in place and effective.

The audit was conducted in accordance with government auditing standards for performance audits.

Compliance

As part of the audit we examined compliance with state statutes relating to the WD and RRD Programs. The statutes addressed:

- Solicitation of views concerning proposed projects from interested and affected parties.
- Division of funds between water development projects and activities.
- Applications for grants and loans to private persons.
- Evaluation of grants and loans to private persons.
- Purchase, operation, and resale of encumbered property.

Generally, we found the programs to be in compliance with applicable laws. Areas for improvement are discussed in more detail in later chapters of the report.

Management Memorandums

During the course of the audit we asked department officials for written responses to certain audit issues. These issues related to potential report sections and recommendations. We also sent management memorandums on other issues. These issues involved:

- Accepting applications after the deadline. We found an application for a project was received after the deadline. The project was ultimately recommended for funding.

- Using negative numbers when scoring environmental impacts of projects. Negative numbers are used to score areas under the current system. Projects with no adverse environmental impacts receive the same "zero score" as those projects with positive environmental impacts. Bureau staff should determine if they obtain desired results with the current scoring process for environmental impacts.

- Removing outdated information and including instructions for use of "Guidelines for Reviewing Applications." We found some questions reviewers use when evaluating projects are no longer applicable. Also, reviewers indicated they would like instructions as to how the bureau wants the "Guidelines" completed. Questions included in the "Guidelines for Reviewing Applications" should be reviewed and instructions for its use should be provided.

-- Documenting changes made to project ranking. The bureau chief and department director can make changes to project ranking. These changes should be better documented.

-- Obtaining copies of contracts entered into by project sponsors. The bureau does not receive copies of contracts between project sponsors and parties providing services. Copies of contracts would provide bureau staff and management a better understanding of project expenditures and activities.

-- Providing necessary materials for project sponsors to compile expenditure reports. Some project files contained expenditure reports completed by bureau staff. Necessary materials should be provided to project sponsors so the sponsors can complete required expenditure reports.

-- Need for the final report on project outcomes to address requirements described in project evaluations presented to the legislature. Even if requirements change, the final report should address those initial requirements and if necessary, why requirements changed. Policies and procedures could ensure requirements presented to the legislature are addressed in the final report.

-- Documenting decisions pertaining to emergency grants. The process used to compare emergency grant applications to applications submitted to the legislature is not documented in files. All information pertaining to decisions made concerning a grant should be documented.

-- Promoting the Private Loan Program. Promotion primarily consists of the program officer attending agriculture organization meetings. Agriculture organizations we talked to indicated they were largely unfamiliar with the program and would like more information. The program could be more actively promoted and applicant response tracked to determine where to concentrate promotion resources.

-- Updating the Private Loan Checklist. A checklist used to ensure complete application documentation does not include all necessary information. The checklist should include documentation needed when a partnership applies for a loan.

-- Need for collection procedures of problem/defaulted private loans. There are no formal procedures to address

various problem/defaulting loan situations. Procedures to follow when dealing with problem or defaulting private loans would benefit the program.

Prior Audit Report Discussed Funding of Projects

In April 1993 we issued a report pertaining to Water Development and Renewable Resource Development Projects (92P-37). The report provided information to the legislature on the process used by DNRC to rank projects, and basic data on project ranking and funding by the legislature. We reviewed the process used by the Resource Development Bureau to solicit public entities to apply for grants and/or loans through the WD and RRD Programs. We also reviewed criteria used by DNRC to rank projects for both programs. We then compared DNRC's ranking and DNRC's recommended funding of projects to ranking and funding approved by the legislature.

In the Water Development and Renewable Resource Development Projects report, we found overall the application process is following statutory guidelines. Potential applicants are notified of the programs. Decisions are based on pre-established criteria. Even though the governor, department director, and the legislature are authorized to change project ranking, historically there have been very few changes.

In the 1993 report we examined the information given the legislature pertaining to project ranking and funding. In this report we examine the processes followed to review and monitor funded projects.

Chapter II
Background

Introduction

The Resource Development Bureau, DNRC, administers the Renewable Resource Grant and Loan Program. This program is a combination of the previous Water Development and Renewable Resource Development Programs. During the 1993 Legislative Session the department requested legislation to combine the two programs since they were similar in administration.

Prior to consolidation, the primary differences between the two programs were applicant eligibility and types of projects eligible for funding. Water and non-water related projects were eligible under the Renewable Resource Development Program, whereas only water-related projects were eligible under the Water Development Program. Under the new program, any project which enhances renewable resources is eligible.

Projects sponsored by private applicants were eligible under the Water Development Program, but were not eligible under the Renewable Resource Development Program. Private applicants continue to be eligible for grants and loans for water-related projects under the Renewable Resource Grant and Loan Program. Public/government entities are also still eligible for funding under the new program. Public/government entities include:

-- Departments, agencies, boards, commissions, or other divisions of state government.
-- Cities.
-- Counties.
-- Conservation districts.
-- Irrigation districts.
-- School districts.
-- Sewer districts.
-- Universities.
-- Water districts.

The following sections describe the previous programs and the new program. Chapter 4 discusses the Private Loan Program. Program expenditures and staffing information complete this chapter.

Chapter II
Background

Water Development Program

The Water Development (WD) Program was established by the 1981 Legislature to promote and advance the beneficial use of water. The program was also created to allow citizens of Montana to achieve full use of the state's water by providing grant and loan financing for water development projects. Applicants had to document how the funded activities and projects would enhance the common well-being of Montanans through measurable conservation and the management, better use, development, or protection of a targeted resource that was water-related.

Water development activities included, but were not limited to:

- Promotion of efficient water use in agriculture.
- Water quality improvement in agriculture and other non-point source uses.
- Protection and enhancement of water-based recreation.
- Control of streambank erosion.
- Control of river and stream sedimentation.

Water development activities were to provide greater local and state management of Montana's water and may or may not have provided marketable benefits.

Water development projects were described as any one of the "works" defined in statute. The definition included:

- Works for the purpose of irrigation, flood prevention, or drainage.*
- Protection or benefit of fish and wildlife.
- Improvement of public, water-based recreation opportunities.
- Development of hydropower.
- Watering of stock.
- Supplying water for public, domestic, industrial, or other uses.
- Fire protection.

* Includes all means of conserving and distributing water, such as reservoirs, dams, diversion canals, waste canals, drainage canals, dikes, lateral ditches and pumping units, mains, pipelines, and waterworks systems for the conservation, storage, distribution, and use of water.

The law required water storage projects be given the highest priority unless another project or activity designed to achieve another objective was demonstrated to be more beneficial to a greater number of people. Eligible water storage projects included efforts which enhanced capacity or rehabilitated existing facilities that were aging and in need of repair.

Public entities could apply for grants for up to $100,000, small loans (up to $200,000), or large loans (over $200,000). These entities could apply for both a loan and a grant.

Program Funding

Funding for the program was derived from various sources. The majority of funding for grants was provided by Resource Indemnity Trust (RIT) interest earnings, after funds were deducted for the Environmental Contingency Account and the Oil and Gas Production Damage Mitigation Account.

To finance loans, DNRC had the authority to issue $10 million of General Obligation Water Development bonds. Approximately $6.5 million of bonds were issued, and $2.9 million were outstanding, as of December 1993.

DNRC was also authorized to issue Coal Severance Tax (CST) bonds of $250 million, subject to approval of the Board of Examiners, to finance loans. As of December 1993, approximately $126.3 million of bonds were issued, and $61 million were outstanding.

Grant and loan funds were appropriated by the legislature from a state special revenue account established for the WD program.

Creation of Emergency Grants

In 1985 the legislature added language to allow the department director to approve grant funds for emergency projects. Emergency projects were approved by the department and defined as those projects which, if delayed until legislative approval could be attained, would cause substantial damages or legal liability to the project sponsor. The legislature appropriated $125,000 each biennium for such projects. Funding was available to help solve

immediate water-related problems faced by state and local governments.

Renewable Resource Development Program

The Renewable Resource Development (RRD) Program was established by the 1975 Legislature to develop renewable natural resources. One aspect of the program was to ensure the quality of existing public resources was not significantly diminished by these developments. Only public entities were eligible to apply for funding under this program.

Funds could be used for:

1. The purchase, lease, or construction of projects which conserved, managed, used, developed, or preserved land, water, fish, wildlife, recreational, or other renewable resources.

2. Projects that provided research and demonstration of farming practices which reduced agricultural chemical use.

3. Feasibility or design studies.

4. Development of plans to rehabilitate, expand, or modify existing projects.

5. Such other and further similar purposes as the legislature approved.

Program Funding

When the RRD Program was established, DNRC was given the authority, with approval of the Board of Examiners, to issue $5 million of general obligation bonds to finance loans. One million dollars of bonds were issued.

A state special revenue account was also established for the RRD Program. The legislature appropriated funds for grants and loans from this state special revenue account. Loans could be issued for up to $200,000, and grants up to $100,000.

Renewable Resource Grant and Loan Program

The Renewable Resource Grant and Loan (RRG&L) Program was established in 1993 to combine the WD and RRD Programs. The WD and RRD Programs were administered as essentially one program for the previous four bienniums. The RRG&L Program keeps elements of both the WD and RRD Programs, and does not expand either eligible projects or eligible applicants.

The purpose of the RRG&L Program is to further the state's policies regarding the conservation, development, and beneficial use of water resources and to invest in renewable natural resource projects that preserve for the citizens of Montana the economic and other benefits of the state's natural heritage. The objectives of the program are to ". . .enhance Montana's renewable resources through projects that measurably conserve, develop, manage, or preserve resources" (section 85-1-602(1), MCA). Developments made by the program may not significantly diminish the quality of existing public resources, such as land, air, fish, wildlife, and recreation opportunities.

Program Funding

A special revenue account was created in 1993 for the RRG&L Program. Funds deposited in the account are received from the following sources:

1. All revenue from state-owned water resource projects and other related money as provided in section 85-1-332, MCA.
2. The remainder of the 2.5 percent of total CST proceeds allocated to the water development debt service fund after debt service requirements are met.
3. Any fees collected from loan repayments to DNRC for servicing loans.
4. Effective July 1, 1993, 38 percent of RIT interest earnings after funds are deducted for the Environmental Contingency Account and the Oil and Gas Production Damage Mitigation Account and 36 percent of RIT interest earnings after deductions effective July 1, 1995.

5. Effective July 1, 1993, 15 percent of the RIT proceeds, and 10 percent effective July 1, 1995.

Also deposited in the RRG&L Special Revenue Account at the beginning of each biennium, effective July 1, 1993, is $1,025,000 from the interest income of the Resource Indemnity Trust Fund. Effective July 1, 1996, the amount to be deposited at the beginning of each biennium is $2 million. These deposits can only be appropriated by the legislature for renewable resource grants. Loan funds are obtained from the sale of General Obligation Renewable Resource bonds (formerly General Obligation Water Development bonds) and Coal Severance Tax bonds. State law authorizes the legislature to appropriate grant and loan funds to public/governmental entities from the state special revenue account.

Grants and Loans Available for Emergencies

The department has statutory authority each biennium to request up to 10 percent of the grant funds available, and up to $1 million for loans, for emergency projects. The project must be eligible for grant or loan funding through the regular process, but because of the nature of the problem, if the project is delayed until the next legislative session there would be substantial damage or legal liability to the project sponsor. The project also must mitigate an established human health or safety problem. Emergency grants or loans may not be made because of gross negligence of the state or local government applicant. The 1993 Legislature appropriated $125,000 for grants for the 1995 biennium.

Expenditures and FTE

Expenditures for the administration of the separate WD and RRD Programs were made from the state special revenue accounts described above. The majority of program administration expenditures were for personal services. Table 1 shows total expenditures and Full-Time Equivalents (FTE) for the two programs for fiscal years 1990-91 through 1992-93.

Table 1

Total Expenditures and FTE for WD and RRD Programs (Unaudited)
(FY 1990-91 through 1992-93)

	Fiscal Year 1990-91		Fiscal Year 1991-92		Fiscal Year 1992-93	
	Expenses	FTE	Expenses	FTE	Expenses	FTE
Personal Services	$168,022	5.32	$159,152	4.54	$160,220	4.34
Operating Expenses	51,902		69,109		55,756	
Equipment	2,002		16,536		6,202	
Computer Lease Payment	1,822		1,709		1,817	
Total	$223,748		$246,506		$223,995	

Source: Compiled by the Office of the Legislative Auditor from the Statewide Budgeting and Accounting System.

Table 2 breaks down FTE by various responsibility centers for the WD and RRD Programs for fiscal years 1990-91 through 1992-93. The table indicates most staff time was in the Water Development Program.

Table 2

FTE for WD and RRD Programs (Unaudited)
(FY 1990-91 through 1992-93)

	Fiscal Year 1990-91	Fiscal Year 1991-92	Fiscal Year 1992-93
WD Public Grant Admin	1.18	1.07	1.08
WD Public Loan Admin	2.94	2.31	2.44
WD Private Loan Admin	0.95	0.98	0.78
RRD Grant Admin	0.24	0.14	0.03
RRD Loan Admin	0.01	0.04	0.01

Source: Compiled by the Office of the Legislative Auditor from the Statewide Budgeting and Accounting System.

Funds were distributed for WD grants and loans and RRD grants from the special revenue accounts. Approximately $1.5 million

was disbursed for WD grants, and $10.7 million for WD loans, for fiscal years 1990-91 through 1992-93. Disbursements for RRD grants were approximately $2 million. The following table shows the amounts disbursed, by fiscal year, for WD loans and WD and RRD grants.

Table 3

Disbursements for WD Grants and Loans and RRD Grants (Unaudited)
(FY 1990-91 through 1992-93)

	Fiscal Year			
	1990-91	1991-92	1992-93	Total
WD Loan	$3,363,517	$705,000	$6,600,000	$10,668,517
WD Grant	491,651	230,336	784,413	1,506,400
RRD Grant	744,867	95,467	1,131,500	1,971,834

Source: Compiled by the Office of the Legislative Auditor from the Statewide Budgeting and Accounting System and department records.

Chapter III
Public Grant and Loan Administration

Introduction

During our audit we reviewed administration of grants and loans funded under the Water Development Program and Renewable Resource Development Program. The Renewable Resource Grant and Loan Program is administered in a manner similar to the previous programs. Our review of program administration included:

1. The process used by bureau staff to review grant and loan applications.

2. Grant and loan recipient compliance with the project contract/agreement for submission of required information.

3. Monitoring of grant and loan projects by bureau staff.

The following sections discuss our findings and conclusions in each of the above areas.

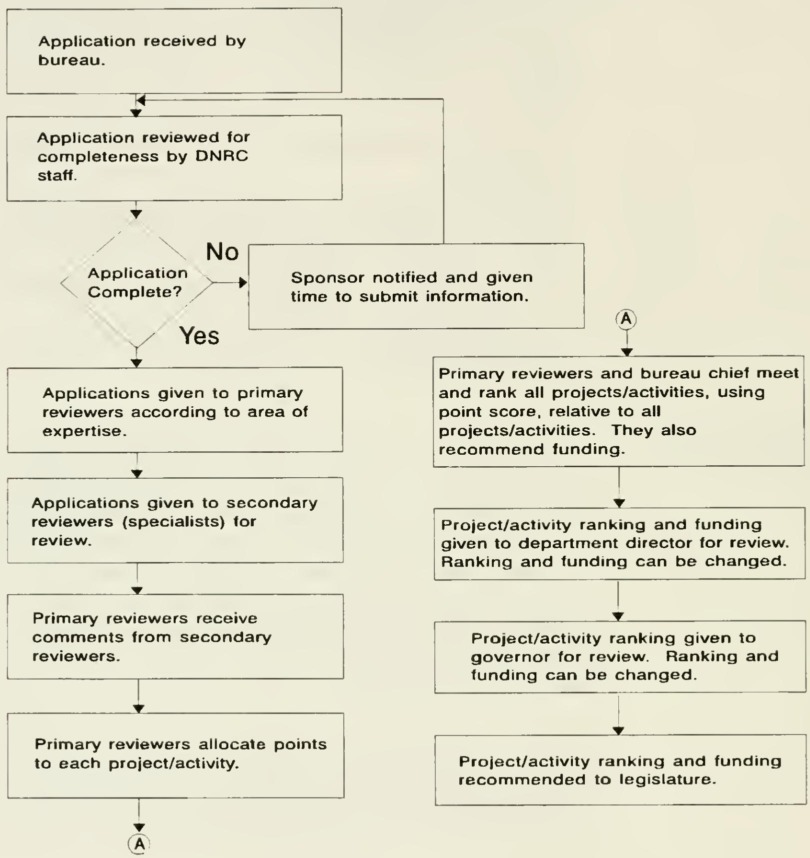
Review of Public Grants and Loans

Applications for a public Water Development (WD) Program or Renewable Resource Development (RRD) Program grant and/or loan are accepted by the Resource Development Bureau, Department of Natural Resources and Conservation (DNRC), until May 15 of each even numbered year. A $250 application fee is required with the application. Applications are reviewed for technical, economic, environmental, and financial feasibility. All applications are also reviewed to determine if an environmental analysis is needed.

Figure 1 shows the flow of the grant application review and ranking process. The flow is similar for loans, but projects requesting loans are not ranked. Grant applications are ranked since limited funds are available for grants.

Figure 1

Flowchart of Grant Application Review and Ranking Process



Source: Compiled by the Office of the Legislative Auditor from department records.

Applications Submitted by Project Sponsors

The Resource Development Bureau sends applications to interested entities. Information requested in the application includes:

-- A proposal abstract describing the project's merits.
-- A technical narrative describing the proposal's purpose, the specific objectives to be achieved, and how the project will achieve the objectives.
-- A financial narrative showing the funding sources and the project's proposed budget.
-- Budgets which include complete and accurate estimated costs.
-- Public benefits.
-- Need and urgency of the project.
-- An environmental assessment.

Review Questions did not Match Application Information

When reviewers examine grant and loan applications for the WD and RRD Programs, they are asked to answer questions on the "Guidelines for Reviewing Applications." These questions pertain to technical and financial feasibility of projects and include:

<u>Technical Feasibility</u>

1. Is the project, or the problem to be solved, completely and adequately defined and documented?
2. Does the application discuss all efforts made in the past, successfully or unsuccessfully, to correct the current problem?
3. Have all appropriate solution alternatives been addressed?
4. Will a useful final product be produced as a direct result of funding this project?
5. Does the technical data submitted support the proposal's need and urgency?

<u>Financial Feasibility</u>

1. Is the project budget properly developed? Does the spending plan meet the project's needs?
2. Are cost estimates realistic?
3. Is there adequate documentation showing how costs were derived?
4. If it is a long-term project, has the applicant identified any future funding sources or whether the activity will become more or less self-sufficient?

When we compared questions in the "Guidelines" to the application we found some questions pertain to information not specifically requested in the application. For example, the application does not ask the sponsor: 1) if the project will be completed within the biennium, or if it requires a longer term funding source, 2) if the applicant has identified any future funding sources for a long-term project, 3) if the planning has been coordinated through local, state or federal agencies which are typically involved with or have authority over such actions as described in the application, and 4) what the trade-offs are of not selecting other alternatives.

If someone familiar with grant applications completes the application, information which answers the questions in the "Guidelines for Reviewing Applications" is usually included. If someone with less experience completes the application, some questions are not addressed or not addressed in the detail necessary for the reviewer. According to one primary reviewer, these applications tend to rank lower than other projects. In addition, reviewers tend to place more phone calls to these sponsors requesting additional information.

The questions asked on the "Guidelines" are important for reviewers to consider in their evaluations of applications. If the department evaluates the technical and financial feasibility of a project based upon questions in the "Guidelines", those questions should be in the application so all applicants are aware of information needed for appropriate evaluation.

During the audit we recommended the Resource Development Bureau include questions contained in "Guidelines for Reviewing Applications" in the application. Officials agreed and indicated they would make necessary changes to the application.

Agency Action: Changed Application Form

The bureau changed the application form to include the questions in "Guidelines for Reviewing Applications."

Solicitation of Views

State law requires the department to solicit views of interested and affected parties, including local, state, and federal agencies, concerning projects submitted for grant and loan funding. For projects submitted to the 1993 Legislature, bureau staff sent notices to newspapers in the locale of proposed projects. For example, a news release was sent to the newspaper in Lewistown asking for comments concerning projects in Hilger, Winnet, Petroleum County, and Fergus County.

Conclusion: Department in Compliance with Law

Our review showed the department is in compliance with the law requiring solicitation of views concerning proposed projects. News releases requesting comments on proposed projects were sent to local newspapers. Federal and state agencies were also able to respond to projects through their participation in the application review process.

Evaluation of Applications by Reviewers

After applications are reviewed for completeness, and any additional information obtained from the sponsor, completed applications are given to primary reviewers for evaluation. Projects are assigned to reviewers based on the reviewer's area of expertise. Primary reviewers include personnel from other divisions within DNRC, other state agencies, and contracted private firms.

For a technical evaluation of an application, primary reviewers can request the services of secondary reviewers. Personnel from other state agencies, federal agencies, environmental groups, private organizations, and the Montana University System were used for technical reviews of projects presented in the 1993 session.

Information for Reviewers

For projects presented in the 1993 Legislative Session, primary reviewers were given information concerning the program, all the application information received by the department, a scoring sheet, and "Guidelines for Reviewing Applications." Secondary reviewers were given the application, with any supplemental information, and "Guidelines for Reviewing Applications."

Criteria given to reviewers to evaluate projects consisted of information on the scoring sheet, which we determined followed state statute and rule. The "Guidelines" for the technical and financial review did not include specific criteria, but contained questions to be considered when reviewing technical and financial aspects of projects.

Conclusion: Reviewers Given Enough Information

We interviewed all primary reviewers and a sample of secondary reviewers. All reviewers believed they were given enough information by the bureau to conduct the review as prescribed by the bureau. In some cases project sponsors were called to obtain additional information. Reviewers were instructed by the bureau to call sponsors if needed.

Conclusion: Information Given Reviewers Appropriate

We also determined information given reviewers was appropriate given the items they review and how they conduct their reviews. The reviewers told us they used the "Guidelines for Reviewing Applications" to obtain an idea of what they were reviewing for, then read the application to determine if criteria were met and if other information was needed. After receiving any other necessary information they conducted a more detailed review and completed the scoring sheet for assigned projects. Secondary reviewers were not required to complete a scoring sheet since information they provided was incorporated in the primary reviewers' decisions.

Documentation of Scores Assigned by Primary Reviewers

For the 1993 Legislative Session, applications were scored on financial feasibility, environmental impacts, technical feasibility, public benefit, public need/health and human safety, and urgency. A total of 1,000 points was available.

We reviewed public grant files for the 1991 and 1993 Legislative Sessions. We found the documentation and scoring process used for the 1991 Legislative Session was not as detailed as that required for the 1993 session. For the latter session, department policy requested reviewers to document the reasoning for the score given in each area and to write a narrative for the information given the legislature.

Conclusion: Documentation Requirements Should be Continued

Our review showed documentation requirements for the 1993 session projects were followed. We believe the process developed for the 1993 session should continue to be used in the future.

Financial Feasibility Information not in the Scoring Sheet

Financial information requested in the application includes the project's budget, sources of all cost estimates, funding sources, and, if long-term, whether the project will be self-sustaining. Questions in "Guidelines for Reviewing Applications" pertaining to financial feasibility include: is there adequate documentation showing how costs are derived; are cost estimates realistic; is there overspending; and if it is a long-term project, has the applicant identified any future funding sources?

During our review of the grant application, we found not all the financial information requested in the application is incorporated on the scoring sheet and subsequently is not used by reviewers when they score projects. The scoring sheet does not directly consider the financial feasibility of a project. The section of the scoring sheet pertaining to financial evaluation only requires reviewers to consider whether project sponsors have secured funding to cover the project's entire cost.

From information observed in bureau files, reviewers who evaluated projects submitted to the 1993 Legislature took into consideration some financial questions when evaluating the project's technical feasibility. One area reviewers are asked to evaluate when scoring technical feasibility pertains to the project's budget. Questions consist of: 1) are the costs outlined necessary and reasonable; 2) are there budget items that were overlooked; and 3) has the applicant realistically requested needed funding or are there other sources of funds that could be accessed to reduce the grant? Because of established scoring, we could not determine if technical feasibility scores were affected by lack of good cost estimates or poorly prepared budgets, for example.

By not asking the financial questions on the financial feasibility section of the scoring sheet, future reviewers might not consider financial feasibility questions. Also, there is inconsistency

between reviewers since we found some reviewers considered the information and others did not.

The current scoring sheet may not include all financial information because bureau personnel thought reviewers could not objectively answer financial questions pertaining to cost estimates and budget items asked in "Guidelines for Reviewing Applications." However, responses from reviewers evaluating the 1993 applications indicated budget items, cost estimates, amount of funds requested, and other financial questions can be objectively answered.

During the audit we recommended the Resource Development Bureau include the financial feasibility questions from the "Guidelines for Reviewing Applications" in the scoring sheet used to evaluate projects. Department staff indicated our recommendation would be incorporated into the update of the scoring sheet. The update is planned for spring 1994.

Agency Action: Scoring Sheet Changed

The bureau changed the scoring sheet to include the financial feasibility questions from the "Guidelines for Reviewing Applications."

Grant Ranking Process

After each primary reviewer determined the score for his/her assigned projects, all primary reviewers, the bureau chief and program officer met to discuss the projects and scores. During this process primary reviewers gave a short presentation about each project reviewed and discussed the score given each project. After all presentations, scores for each specific area on the scoring sheet were discussed. The group decided what score each project should receive in relation to all projects. Total scores for WD projects were discussed and the projects then ranked. The group did the same for RRD projects. The two lists were then combined and a final list created.

Conclusion: Ranking Process Reduces Project Scoring Inconsistencies

The ranking process used by the bureau allows bureau personnel and primary reviewers to discuss each project. This discussion reduces inconsistencies between scores given by each reviewer.

Recommendations for Funding Determined

After projects are ranked, bureau personnel determine recommended funding for each project based upon department policy established when the program was created. Policy dictates grant funding is limited to a maximum of $100,000. If no revenue source is available to repay a possible loan, the recommendation is to grant up to 100 percent of the project's total cost but not more than $100,000. Applicants have to provide evidence showing no revenue source is available for loan repayment. Typical grant funding levels for entities with ability to repay loans are at least 25 percent of the project's total cost but no more than $50,000. When reviewing project funding we identified a concern with the basis used for determining funding recommendations.

Basis for Grant Funding Recommendations Needed

In determining the grant funding level to recommend for a municipal entity, Resource Development Bureau personnel indicated they do not analyze an entity's debt structure. Personnel do not determine the additional debt an entity can assume; they follow the $50,000 or $100,000 limits established by policy.

When evaluating projects for the Treasure State Endowment Program (TSEP), the Department of Commerce (DOC) developed a method to analyze debt structures of municipal entities. This analysis is the basis for determining the recommendation for an entity's grant funding. Four principal indicators of financial need are assessed to determine the applicant's need for TSEP funds. The indicators are:

-- Target affordable rates for water or sewer charges - 1.0 to 1.5 percent of median household income.

-- Affordability index - total average household's user fees and tax payments divided by the community's median household income.

-- Debt to household ratio - applicant's total debt (including new debt for the TSEP project) divided by the total number of households to be benefitted by the proposed project.

-- Combined water and sewer rates.

Under TSEP, there are no specific dollar limits an entity can receive through a grant. The maximum amount allowed is up to 75 percent of the total project cost.

Using a method such as that developed by DOC could provide a more equitable distribution of DNRC grant money to municipal entities. We compared funding recommendations made by DOC and DNRC for two towns. Each town's proposals submitted to DOC and to DNRC were essentially the same. The following table shows our comparison.

Table 4

Comparison of DOC and DNRC Grant Funding Recommendations

	DOC			DNRC	
	Financial Need Score*	Cost	Amount Recommended	Cost	Amount Recommended
Town A	300	$726,213	$544,673	$756,300	$50,000
Town B	150	118,700	50,000	94,680	50,000

* Calculated by the Department of Commerce for TSEP.

Source: **Compiled by the Office of the Legislative Auditor from DOC and DNRC records.**

In both cases, funding levels recommended by DNRC (see last column) are the same because debt structures had not been examined. Current DNRC policy only allows a grant funding recommendation of $50,000 for an entity with the ability to repay a loan. If DNRC were to change the funding policies, then municipal entities with greater financial need could be granted additional grant dollars to ease the burden of repaying loans.

Current policy is based upon past DNRC recommendations and Long Range Planning Subcommittee action. There are no statutory dollar limits on public grants. Since DNRC is now analyzing the debt structures of municipal entities, it appears appropriate to rethink the dollar limits established through past practices. Grant funding policies can now be evaluated to

determine if a wider range of dollar limits would better serve the program. If municipal entities with a lower ability to repay a loan could be granted a larger dollar amount, such as $100,000 or $150,000, entities with a higher ability to repay a loan could be granted lesser amounts. We realize program funding does not allow DNRC to finance as much of the cost of the project as allowed under TSEP.

The Long Range Planning Subcommittee approves the grants after receiving public comments and make recommendations to the full committee. Since the subcommittee is an integral part of the process, the department should involve the Long Range Planning Subcommittee in rethinking the dollar limits.

Recommendation #1

We recommend the Resource Development Bureau re-evaluate the dollar limits for Renewable Resource Grant and Loan Program grants and recommend changes in the limits, if necessary, to the Long Range Planning Subcommittee.

Review of Applications by the Department Director

After projects are ranked and funding recommended, the department director reviews the information. The department director can delete projects or change recommended funding and ranking. The following section discusses the director of DNRC reviewing in-house project proposals prior to submission to the Resource Development Bureau.

Proposed In-House Grant Applications Should be Pre-Approved

Other bureaus or divisions in DNRC can apply for grants from the WD and RRD Programs. The Resource Development Bureau accepts the in-house applications, reviews them, and submits them, along with other ranked projects, to the department director for review. For the 1993 session the departing department director deleted one project from the list presented by the bureau. The director believed the project was only a vehicle to

allow a bureau within DNRC to purchase equipment. The director also deleted an in-house project for the 1991 session for the same reason.

The department director should review in-house proposals for Renewable Resource Grant and Loan Program grants before applications are completed and sent to the Resource Development Bureau. The proposal should be reviewed before time is spent by project sponsors to complete the application and Resource Development Bureau staff to review it. For the 1993 session the time spent to review and rank each grant application equated to $600, at a minimum, in staff salaries in the Resource Development Bureau and other bureaus in the department.

Since there is no policy for department bureaus or divisions to submit proposals to the director prior to completing the application, the director was not informed of the 1991 and 1993 proposed grant applications prior to completion and submission to the Resource Development Bureau.

During our audit we informed the department director of the situation. The director indicated a policy would be established which requires approval by the director before submission of a grant application.

Recommendation #2

We recommend in-house proposals for Renewable Resource Grant and Loan Program grants receive director approval before completion and submission of applications to the Resource Development Bureau for evaluation.

Monitoring of Public Grant and Loan Projects

In our previous review of Water Development and Renewable Resource Development Projects (92P-37), we found the Resource Development Bureau had a reasonable process for soliciting applications, and application information was reviewed and specific criteria followed in evaluating projects. During our current audit we extended our review to evaluate the processes used by staff to monitor funded projects. Monitoring projects helps ensure program intent is met.

We found the bureau has not developed formal policies and procedures concerning monitoring. Procedures for monitoring projects to ensure the program's intent is met are primarily driven by project contracts. The bureau obtains a signed grant or loan agreement/contract for each project. The contract requires quarterly progress reports, expenditure reports, and a final report. We found that although the majority of the contract requirements are met, there is limited monitoring or use of the information submitted to the bureau staff. For example:

1. Files do not contain complete documentation of decisions and conversations with sponsors.
2. Initial project objectives are not compared to final results.
3. Final reports are not reviewed to determine project success.
4. Final reports are not readily available to potential users.

The following sections summarize our findings and conclusions in this area.

Quarterly Progress Reports Required

Program applications and project contract/agreements require periodic or quarterly project progress reports. Progress reports are to include information pertaining to percentage of work completed, problems identified, delays, changes in scope, budget changes, and contract extensions.

Conclusion: Progress Reports are Submitted

We reviewed 22 grant and loan files for fiscal years 1988-89 through 1991-92. Our file review verified project files contained the required progress reports.

Projects are not Actively Monitored

Managing a program includes monitoring projects to ensure projects meet the statutory purpose of the program. Monitoring projects should include tracking and evaluating the contracts. We found little evidence in the files of staff tracking or evaluating projects. Files contained minimal documentation and final reports are not evaluated to ensure initial objectives are discussed or the project was successful in meeting the objectives of the project and the program.

Documentation in Files Limited

We found little documentation in files indicating contact with project sponsors except quarterly progress reports, expenditure reports, and form letters sent at specific milestones in the project. Although we are aware of other contact with sponsors, this is not always documented in the files.

In talking to project sponsors, they noted problems with staff turnover. When sponsors called new staff with questions it took extra time for staff to become familiar with the project. We found project files contained limited documentation of conversations between prior staff and sponsors. Current staff is following the same procedure. Without maintaining documentation in the file of phone conversations or decisions made, the primary source of historical information is the sponsor. This results in inefficiencies in staff time.

We also found bureau staff do not consistently document on-site visits to funded projects. Visits to projects are necessary to verify projects are progressing as outlined in the contract and progress reports. Documentation of on-site visits provides an accurate record of activities associated with each grant or loan. Documentation of visits also allows bureau personnel to track the progress of projects.

Audit work included three on-site inspections with bureau staff. We later reviewed two of the three project files. Neither file contained documentation of site visits. Seven of seventeen project files from the 1989 session, and six of seven project files reviewed from the 1991 session, contained no documentation of site visits.

Bureau staff indicated other state agencies frequently are involved with projects funded through the bureau. Staff contend the bureau relies on the involvement and expertise of the other agencies so bureau staff do not need to visit those projects. We found project files contained limited documentation to verify the bureau's reliance on other agencies' involvement.

Comparison to Objectives not Required

All sponsors of projects funded by the legislature are required by the contract/agreement to submit a final report. During our audit we found final reports in all completed project files we reviewed. The Resource Development Bureau sends a "Suggested Final Report Format" form to sponsors which suggests the final report include: 1) planning process used, 2) critical elements particular to the project, 3) a summary of problems encountered and solutions adopted, and 4) clearly stated recommendations. The form does not require the final report to contain a comparison of proposed objectives, as stated in the application and the report given the legislature, to actual project accomplishments.

Our review of 14 reports showed 10 final reports contained a comparison of initial objectives with actual project accomplishments. Four reports did not. To help ensure all final report documents compare proposed objectives with actual accomplishments, the "Suggested Final Report Format" form should include a reference to this comparison and any changes from proposed objectives as stated in the application and the report given to the legislature.

Evaluation of Final Reports Lacking

Due to lack of documentation in the files, we could not determine if bureau staff review final project reports to evaluate the accomplishments or success of projects and the program. Without a review of the final project report, the bureau can not determine if projects successfully meet the initial objectives of the project. A review of final reports would allow the bureau to measure its own outcomes, (i.e. if the program is meeting its purpose as stated in state law). If comparison of original objectives with final accomplishments identifies a significant difference, then staff may choose to look at the current application

evaluation process and determine if the process for evaluating applications should be changed.

Evaluation of final reports will allow the bureau to determine if the program is measurably developing, managing, conserving, and preserving Montana's natural resources.

Recommendation #3

We recommend the Resource Development Bureau improve monitoring of projects by:

A. Documenting decisions and conversations that affect on-going projects.

B. Including the requirement to compare proposed objectives to actual project accomplishments in the final report in the "Suggested Final Report Format" form.

C. Formally reviewing and evaluating final reports.

Final Reports not Distributed for Public Use

We found the Resource Development Bureau has not established a mechanism for DNRC to disseminate the information from projects which result in a report or study. The information obtained through completion of funded projects should be available to people to use. The information could reduce the duplication of effort by project sponsors.

When talking to a sample of sponsors, one indicated the project just completed could be used as a model for other cities. When asked how information about the project would be available for other sponsors, the sponsor said it was his understanding DNRC will make the information available. Bureau staff indicated they were not planning to distribute the information.

Bureau staff did indicate a library of final reports will be established when there is time. Staff also indicated reports might be sent to the State Library for input to the Natural Resource Information System (NRIS) and reports sent to the Water Resource Clearing House in Bozeman. The State Library received funding under the RRD Program in 1990 to establish NRIS.

Under the state depository law, each state agency must deposit at least four copies of each of its state publications with the State Library. Personnel in the State Library indicated they believe reports/studies resulting from grants and loans made under the Renewable Resource Grant and Loan Program fall under the law.

DNRC could indicate in the application that final reports are available from the Resource Development Bureau and that reports or studies resulting from a previously funded project are available from the State Documents Depository Program, Montana State Library. The bulletin developed by the bureau explaining the program could also include information pertaining to the availability of final reports and reports or studies.

Recommendation #4

We recommend the Resource Development Bureau include a clause in the:

A. Application and bulletin that final reports are available from the bureau and reports or studies are available from the State Documents Depository Program, State Library.

B. Grant/loan agreement/contract that at least four copies of the report or study resulting from a funded project with a final product as a report or study be sent to the State Documents Depository Program, State Library.

Chapter IV
Private Loan Program Administration

Introduction

The Water Development Private Loan Program was created by the legislature in 1981. The program is designed to provide low interest loans to individuals, partnerships, associations, corporations, and other private parties. The money is to be used for water-related projects and activities. Any project that conserves, distributes, stores, or otherwise uses water for a beneficial use is eligible for funding. The department approves loans with no legislative involvement.

Loans cannot exceed $200,000 and repayment periods are the lesser of 30 years or life of the equipment purchased. Funds for loans are generated through the sale of state General Obligation bonds.

The following sections contain information concerning the number of loans issued and defaulted, program administration, and our findings and conclusions for the program.

Number of Loans Issued

From inception of the program in 1981 through June 1993, 97 loans were issued for a total of $6.6 million. Of the 97 loans issued, 16 were satisfied as of July 1993. The principal amount repaid from the 16 loans was $1,148,137. The following table summarizes loan activity for fiscal years 1981-82 through 1992-93.

Table 5

Water Development Private Loans Issued
(FY 1981-82 through 1992-93)

Fiscal Year	Number of Loans	Dollar Amount
1981-82	2	$ 44,915
1982-83	2	63,400
1983-84	6	544,834
1984-85	13	721,826
1985-86	26	1,828,272
1986-87	4	255,013
1987-88	6	363,885
1988-89	11	557,570
1989-90	8	844,806
1990-91	5	445,906
1991-92	5	285,280
1992-93	9	620,975
Total	97	$6,576,682

Source: Compiled by the Office of the Legislative Auditor from department records.

Individual loan amounts range from $9,915 to $200,000. Of the 97 loans, 23 were for amounts between $40,000 and $50,000. Approximately half of all loans were for less than $50,000. The following table shows the number of loans in various dollar ranges.

Table 6

Number of Loans in Specific Dollar Ranges
(FY 1981-82 through 1992-93)

Dollar Range	Number of Loans
Less than $20,000	6
$20,000 to $39,999	18
$40,000 to $59,999	30
$60,000 to $79,999	14
$80,000 to $99,999	12
$100,000 to $119,999	5
$120,000 to $199,999	8
$200,000	4

Source: Compiled by the Office of the Legislative Auditor from department records.

Number of Defaulted/Problem Loans

Over the life of the Private Loan Program two loans have defaulted and the department lost principal and interest. The department also lost a portion of the principal and interest of other loans. Both principal and interest are lost since the loans are financed by the sale of state General Obligation bonds. The principal and interest on the bonds must be paid even if the borrower defaults on the loan.

The following summarizes the different types of defaulted/problem loans and amount of money lost or potentially lost. All of these loans were issued prior to 1987.

Table 7

Summary of Defaulted/Problem Loans
(As of August 1993)

	Amount of Loan/ Year Issued	Amount Lost Principal	Interest
Loans Written-Off	$200,000/1986	$200,000	$107,721
	$ 37,536/1986	$ 20,126	$ 17,548
Loans with Partial Loss	$ 50,659/1985	$ 201	$ 10,026
Loans with Potential Loss (in Bankruptcy)	$175,000/1984	$ 92,438*	$147,015*
Problem Loans with Potential Losses	$119,980/1986	Potential loss (if any) not known	
	$109,750/1986	Potential loss may be $50,000	
	$ 85,000/1986	Potential loss (if any) not known	
Loans Assumed by Other Parties	$156,903/1984,85	$ 54,308	

* These amounts will be lost under the bankruptcy plan if the person cannot pay the entire amount of the loan and interest.

Source: Compiled by the Office of the Legislative Auditor from department records.

The $54,308 loss from loans assumed by other parties resulted from the cost to sell the land. When the loan defaulted, DNRC held the second mortgage on the land which was used as security. To obtain first rights to the land, DNRC purchased the first party's lien. DNRC then sold the land. The transaction was in compliance with section 85-1-615, MCA, which allows the state to purchase a lien that is prior to the state's lien and then sell the land as expeditiously as possible.

As of August 1993, the department was dealing with three borrowers who were experiencing difficulties making their payments.

Role of the Program

Bureau staff and management indicated the intent of the Water Development Private Loan program is to develop water resources and fill a financial niche banks will not handle. Management stated the program puts the state in the role of a "bank" within the parameters of state statutes. They indicated the main considerations a bank makes when evaluating a loan are: Financial Position and Progress, Repayment Capacity, Purpose of the Loan, Collateral (Security), and the Person. For the Private Loan Program, the department said Purpose and Collateral are narrowly defined. The three remaining factors are weighed in making the final decision on each individual application. Management gave the following example as to how the three factors would be considered:

> "An individual who has a relatively weak financial position, limited repayment capacity, but who has stayed in his chosen field and paid his bills (a beginning farmer), who has a very good reputation with his local banker and the local suppliers, who will benefit from the loan, and whose project conserves the available water will in most cases be approved for a loan."

When determining whether to loan money, a bank emphasizes the financial position and progress, and repayment capacity of the entity requesting the money. Department management indicated the Private Loan Program emphasizes collateral, the person, and the purpose of the loan.

Administration of the program is discussed in the following sections.

Private Loan Program Administration

Loan applications can be submitted at any time to DNRC. Bureau staff review applications for completeness. If the application and required documentation are not complete the applicant is notified and given a specific time period to complete the requirements. Staff evaluate the proposed project for compliance with state law and technical and financial feasibility. If deemed necessary, staff will visit the proposed project site.

Review for Compliance with State Law

Section 85-1-608(1), MCA, requires projects be constructed, developed, and operated in Montana. Section 85-1-608(2), MCA, requires the application to contain necessary information to allow an evaluation of the project. Criteria and preferences to follow when evaluating projects is contained in section 85-1-610, MCA. This law includes requirements for the project to provide public benefits, be used as part of a family farm, and fully utilize water resources.

Conclusion: Department in Compliance with State Law

We reviewed 15 applications submitted from fiscal year 1989-90 through 1992-93 for compliance with state law. We found the department is in compliance with sections 85-1-608(1),(2) and 85-1-610, MCA.

Review for Technical Feasibility

If the U.S. Soil Conservation Service (SCS) designed the project bureau staff do not conduct an in-depth technical review. If the project is not designed by the SCS the bureau has an engineer in DNRC review the technical aspects. The bureau prefers to have the SCS or a private professional engineer design projects.

Review for Financial Feasibility

The application for a private loan requires specific financial documentation, including:

- A construction budget (with accompanying cost estimates) showing project costs and project funding.
- A statement of financial condition showing assets and liabilities.
- A three year profit and loss statement, excluding project income or expenses.
- Documentation of income sources.
- A three year projected operating budget showing only project income and expenses.
- A description of loan collateral.
- Abstract of title or other evidence of ownership.
- Other funding commitments or status documentation.

Not All Financial Information Used

During our review we found Private Loan Program staff do not use all the financial information required as stated in draft policies and procedures or as used by a private lending institution. The position description for Private Loan Program staff indicates the applicant's financial statements, earnings, expenses and cash flow projections are to be evaluated. Draft policies and procedures state "The individual operation also needs to be evaluated on a cash flow basis. This can best be done by reviewing operator's past two or three years tax returns." When private loan companies determine credit worthiness they review tax returns, conduct cash flow analyses, and calculate the breakeven point for the person's entire operation including the new project.

Currently, staff determine a debt to equity ratio and net worth to total liabilities ratio. Overall cash flow of the operation is not calculated, nor is a review of past tax returns necessarily completed. Staff determine a breakeven figure for the project but not for the overall operation of the farm or ranch.

Section 85-1-609(4), MCA, requires the loan applicant to be credit worthy. We believe bureau staff could better determine credit worthiness of applicants using some additional financial information. Although none of the borrowers awarded loans since current staff were hired in 1987 have defaulted, a few have not made payments timely or consistently.

Our review of files indicated many decisions to approve loan applications are based on need and reputation of the operator, and upon the program officer's interpretation of criteria. When we compared the financial information to program criteria or commercial loan practices there were inconsistencies. We found staff did not confirm some information, did not use information on tax returns, did not calculate breakeven points for the entire operation, or did not use current assets to current debt and net worth to total liabilities ratios.

Our review of the profit and loss statements for one applicant showed a loss from the project the first year, in addition to a projected loss for the overall operation, without the new project.

None of the figures on the profit and loss statements were confirmed with income tax returns. Staff did not follow-up to verify operating costs or project production.

In the same applicant's file we found ratios were weak. Ratio results showed current debts exceeded current assets. Informal policies indicate current assets should be two times current debts and net worth should be two times total liabilities. The policy also states these guidelines can be deviated from if there are good and sufficient reasons to do so.

The applicant was given a good character reference by the bank and the Farmers Home Administration. Staff's recommendation to the director concerning the loan said the project would pay for itself, with a modest profit. The recommendation also indicated the financial position is weak, but the applicant should be given a loan.

For another loan the profit and loss statements from 1989 to 1993 showed modest profits each year with reasonable operating costs. Tax returns, after adding depreciation back in, which gives an estimated cash income or loss, showed a net loss of $4,352 from 1989 through 1991. Staff's recommendation to the director indicated although the financial statement is fair, it is not as strong as the program officer would like to see. The program officer indicated the applicant has an excellent reputation with his local banker and has been successful in the farming business for the last 15 years so approval of the loan was recommended.

A third loan showed financial statement information for three people. Based on our review, it appeared information was overstated. The information on the statements was not confirmed by the program officer. The financial statements contained values of machinery, equipment, cars, or trucks but there were no attached schedules showing this information. Information from schedules was not carried over to other pages, and not all information was completed on the application. There were no details from the applicant as to how they derived the projected income from the project. Also, no ratios were deter-

mined by the program officer. Staff recommended approval of the loan since security was more than adequate and repayment of the loan was reliable. The first payment to the department was made after a letter was sent stating the payment was 15 days late.

Bureau staff explained inconsistencies in financial information is not as important as program intent which is to develop water resources. Staff indicated loans which consider the operator's potential instead of strict financial criteria carry a higher risk than commercial lenders might be willing to carry. Bureau staff also explained the applicant has a choice of form to use to supply financial information. Usually information is supplied by application forms. Tax returns are not required or requested.

In response to our recommendation for policies and procedures, department staff indicated they thought we wanted a "cookbook" approach for procedures and that such an approach rarely works for credit as every situation is different and unique. The department is correct in that every situation is different and unique so "cookbook" procedures would not be appropriate.

We believe policies could be developed which outline what financial documents are required. General procedures could then be written concerning the type of financial information to be obtained and analyzed from the documents, and guidelines to follow when considering all the information gathered. This may include, but is not limited to, breakeven points, overall cash flow, debt to equity ratio, net worth, etc. General guidelines for ratios have already been established (current assets should be two times current debts and net worth should be two times total liabilities). Such guidelines could be established for other financial information. All necessary information could then be used to determine credit worthiness of an applicant.

Recommendation #5

We recommend the Resource Development Bureau:

A. Adopt a formal policy identifying what financial information to collect and use to determine financial status of an applicant.

B. Implement written procedures to evaluate loan applications using the financial information gathered.

Loan Denial or Approval

After reviewing technical and financial information, bureau staff determine if the project should be funded. If the information provided indicates the project would be risky because there is not sufficient security or a bad financial position, bureau staff write a letter to the sponsor indicating the project will not be funded. Our review of files indicated six applications from 1988 through 1992 were denied. Five were denied due to lack of security and one because of bad financial position.

If financial position and security are deemed adequate, a recommendation is written for the director's approval. The recommendation includes a brief description of the project, the economic feasibility which includes the financial history of the applicant and how the project will pay for itself, and security offered. The director or deputy signs the recommendation.

Collateral Secured and Loan Made

Upon approval of the recommendation to make the loan, the project sponsors are notified, and bureau staff proceed to secure the collateral used for the loan. Collateral can be either real estate or the equipment purchased by project funds.

The value of land used for collateral is based on assessed land values throughout the state and related local land values. Land which seems to be artificially inflated due to scenic value or

location is revalued based on its agricultural production. Bureau practice is to have the value of the land be 125 to 150 percent of the loan amount. So a $100,000 loan requires collateral of land valued at $125,000 to $150,000. Bureau staff value equipment at 50 percent of the current value. The bureau prefers land as collateral.

Once collateral is determined, mortgage forms are filed with proper officials. An installment loan agreement and interim construction agreement are drawn up and signed by the department and the applicant. Payments are made to the borrower upon DNRC receipt of documentation of vendor payment.

On-Site Visits to Projects

Visits to projects can provide staff with information to determine if the project promotes, enhances, or advances the purpose, policies, and objectives of the Renewable Resource Grant and Loan Program. Personnel indicated they visit a project at least once when under construction and pay a second visit if in the area. Non-irrigation projects are a priority for an on-site visit. When the project is competed, staff determine if the project meets the description in the loan application and if the project works.

Visits to Projects are not Documented

We reviewed files of 15 projects issued loans from fiscal year 1989-90 through 1992-93. We found there was no documentation of visits to projects in the files. Staff indicated if problems with the project are noted something should be in the file. We could not find any indication of this in the files we reviewed. There are no formal procedures for visiting Private Loan Program projects or documenting those visits.

Visits to projects ensure sponsors complete projects in the way described in the application and the project meets the statutory purpose of the program. Documentation of visits to projects allows the department to document any violations of the construction agreement.

Bureau staff indicated visits are not always necessary because private operators have a vested interest in the system. According

to staff, private operators want the best system they can get so they are not going to cut corners.

During our audit we recommended the Resource Development Bureau establish procedures to perform and document on-site visits to projects funded with Private Loan Program funds. Department management indicated our recommendation to establish procedures to perform and document project inspections has merit and will be addressed by the bureau.

Agency Action: Trips are Documented

Bureau staff are now documenting the results of on-site visits to projects funded with Private Loan Program funds.

Payments Start

Payment schedules are established in the loan agreement to correspond to the time of year best suited for the borrower. Payments are made to Centralized Services Division, DNRC. A print-out showing amount of payment, amount applied to principal, amount applied to interest, and any late fees charged is given to Resource Development Bureau staff.

Reasoning for Dismissing Late Fees not Documented

When a person does not submit a payment by the due date, the Resource Development Bureau sends a letter stating the payment must be made within 15 days of the due date before late fees will be charged. The current loan agreement states late fees in the amount of 2 percent of the late payment per month are due when the payment is made in excess of 15 days of the payment due date. Late fees are charged to recover additional administrative costs and to encourage prompt payment by borrowers.

Of 13 files we reviewed with late payments, six borrowers paid late fees, five had fees dismissed, and two borrowers had late fees dismissed one time and not another. Both of these latter loans had no documentation in the files as to why late fees were waived. Of the five loans with fees waived for all instances, there was no documentation for waivers in three files, and documentation for waivers in one file. The fifth file documented one waiver, but not another waiver. There was no

documentation in any of the files of an approval by bureau management of the decision.

We found there are no policies or procedures specifying when a late fee should or should not be dismissed. Bureau personnel dismiss some late fees without documenting the reason for dismissal. Also, there is no documentation of approval by bureau management concerning staff's decisions pertaining to dismissing/collecting late fees.

Policies and procedures and documentation requirements for the assessment or waiver of late fees are needed to ensure bureau staff consistently apply late fees. Currently, a person new to the program would not be able to understand the reasoning for dismissing some fees and not others. Without approval to dismiss late fees, bureau management is not aware of the program officer's decisions.

We informed the department of our concern. Management indicated they would start documenting the reasoning for dismissing late fees. To ensure consistency, we also believe policies and procedures and management approval are needed.

Recommendation #6

We recommend the Resource Development Bureau:

A. Develop policies, procedures, and documentation requirements for the assessment or waiver of late fees.

B. Require management approval for dismissal of late fees.

Loans are not Monitored After Issuance

State law requires an applicant to have adequate financial resources to construct, operate, and maintain the project, and to be credit worthy. Administrative Rules of Montana, section 36.17.303, states: "The department will require periodic progress and fiscal reports from the project sponsor." The program officer's position description also cites a duty to monitor borrower performance through periodic interviews with borrowers requiring updated financial statements and making field reviews to detect adverse financial changes. The program officer is to make recommendations for corrective actions as necessary. The application booklet says the applicant may also be required to submit annual financial reports during the life of the loan.

We found bureau staff do not monitor the loan, or follow-up on the financial position of the applicant, after the loan is made. The program officer does monitor loans which are in bankruptcy or are defaulted but no others.

We do not believe the department needs to obtain annual statements from every borrower, but should monitor those borrowers who are not able to make timely payments. Department staff could provide these borrowers with options to the current payment schedule, which is usually one payment each year. Options could include only paying the interest for a number of years, or making payments throughout the year instead making one large payment each year. Past experience has shown the department has not done well when the borrower has defaulted on the loan and the department had to rely on the security established for the loan, as can be seen in the table on page 36.

During the audit we recommended the Resource Development Bureau formally develop and implement procedures to monitor the financial status of Private Loan Program borrowers who are delinquent in making payments. In response to our recommendation, management indicated they would add a provision to their Repayment Agreement to require a borrower who is delinquent over 60 days to submit an annual financial statement until he has made three regularly scheduled payments. We

believe this type of procedure will help the department be aware of potential problems and possibly alleviate any future problems.

Agency Action: Contract Language Changed

The bureau changed the boilerplate language for the Private Loan Repayment Agreement to indicate a borrower delinquent in payments in excess of 30 days may be required to submit annual financial statements to the department for three years.

Documentation of Loan Information

Maintaining adequate documentation in files is important to the general operation of the Private Loan Program. Files should provide an accurate record of all activities associated with each loan. Adequate documentation is important to support decisions and actions taken by the program officer and department. Information should be documented in such a manner people using the file can readily determine what decisions were made, and the basis for those decisions.

Private lenders require telephone conversations be documented (date of call, person talked to, and the general topic discussed). Any decisions pertaining to the loan, such as restructuring, should be completely documented.

Without adequate documentation, someone reviewing the file may not be able to determine how decisions were reached. In some cases we could not tell if bankers had been called, or if the program officer had talked to the applicant during the review process. Two borrowers were having difficulties making payments, but there was nothing in the files which would indicate the loan officer was in contact with the borrowers between payments to determine the status of their operation. There were just short notes in the files indicating they will make payments when they are able, or to thank the loan officer for his patience.

We informed the department of the need for improved documentation. Management indicated staff acknowledges the need for better documentation on how loan decisions are made.

Recommendation #7

We recommend the Resource Development Bureau improve documentation of information leading to decisions concerning loans made under the Private Loan Program.

Review of Project Success

The department is required to evaluate and determine eligibility of projects based upon criteria established in law. Loan proposals are initially evaluated to determine eligibility for a loan. Eligibility criteria requires the proposed water-related project to ". . .promote, enhance, or advance the purpose, policies, and objectives of the renewable resource grant and loan program" (section 85-1-609(1)(a), MCA). The purpose of the grant and loan program is to measurably conserve, manage, develop, and conserve Montana's natural resources.

We found staff do not determine if completed projects meet the purpose as specified in law. Determining project effectiveness is necessary to determine which projects are successful in meeting program objectives. Without a review of project success and resulting documentation, department management and the legislature can not determine if the program is effective and meeting objectives stated in law.

Project review also provides a basis for future application review and decision making. If project results do not compare to the results proposed in the application, for example, then application evaluation procedures are in question.

Department management indicted the focus of their "follow-up" or monitoring process is to insure projects are constructed as agreed upon. They indicated all of the projects funded through the program have been completed and work. They also stated the projects also substantially meet the description of the original documentation. The above department comments indicate

comparisons are made but we could not substantiate this since there is no documentation of measurement of results in files. We did find documentation showing the program officer travels to projects but no documentation concerning the result of the visits. Documentation of these comparisons will allow the department to verify to the legislature the program is meeting statutory intent.

Recommendation #8

We recommend the Resource Development Bureau improve documentation of project information to help determine if the Private Loan Program is meeting statutory intent.

Program Officer Authority

The majority of the authority to make decisions pertaining to the Private Loan Program is concentrated in one person. While the program officer is not operating entirely alone, the individual administers a significant amount of funds with more latitude than would be allowed in a similar private banking position.

The program officer reviews loan applications and submits loan recommendations to the Resource Development Bureau chief and the department director. Usually, recommendations are accepted with a minimum of review. Little or no supporting documentation is presented with the recommendation so management is not aware of the original financial information which provides the basis for the loan. The program officer does not make any verbal presentation to management of his findings. There is no secondary review/oversight of his financial decisions. If the program officer does not think the applicant should receive a loan, the program officer will write a letter to the applicant stating the application was denied. No one reviews the decision to deny the loan.

Monthly reports of past due loans are presented to bureau management and the program officer by the program specialist who tracks loan payments. The program officer works with the borrowers who are not making payments to find a solution to the problem. The bureau chief receives periodic reports from the program officer indicating the status of problem loans. The reports are not issued at established time frames, such as weekly, bi-weekly, or monthly.

In contrast, private lenders have a system designed to provide expanded input for the loan decision and monitoring process. A committee reviews the recommendation and supporting financial information; the loan officer submitting the recommendation is present to explain the recommendation and answer questions. This procedure is designed to open the recommendation to review and allows the decision making responsibility to be shared by different levels of management. The committee reviews applications for loans which the officer believes should be made and those which should be denied. The use of a committee to review and approve or deny loan applications ensures the approval process is not concentrated in one person.

When loan payments are not made, the loan officer in a private lending institution obtains information concerning payment status. The loan officer then presents information concerning the status of the loans to management at meetings scheduled at regular time frames.

During our review of files, we found examples of financial information which was not presented to the bureau chief or director for loan approval or for problem loans. One loan file contained tax information which indicated the applicant experienced farm losses for the immediate past three years. This information is used to determine if the applicant has adequate financial resources. The program officer's recommendation did not contain this information and advised approving the loan. The recommendation was reviewed and the loan approved by management. When asked if the loan approval took into account the tax loss, management responded by saying if the information was not in the recommendation, they were unaware of it.

Another loan recommendation indicated the project would pay for itself, but financial information provided by the applicant indicated the project would lose money the first year. In addition, the profit and loss statement for the overall operation indicated a loss, excluding the proposed project.

Two borrowers having difficulties making payments were included in the reports of past due payments, but there was no mention of those borrowers on the periodic reports concerning problem loans. Both borrowers were having problems submitting most of their payments in a timely manner.

We believe the loan approval/denial process should be made by a committee so as to not concentrate the approval process in one person. Also, the program officer should then meet with bureau management on a regular basis to discuss the reasons borrowers are not able to make their payments.

In responding to our recommendation, department management indicated a loan committee consisting of the Program Officer, the Director/Deputy Director, and the Division Administrator/Bureau Chief would be established to review loans. This would be done before the next loan application is approved.

Management indicated the program officer would provide the bureau chief with a quarterly report discussing problem loans. Meetings to discuss problem loans will be held on an as needed basis. Regularly scheduled meetings between the program officer and bureau chief would ensure the bureau chief the program officer is in contact with borrowers.

Recommendation #9

We recommend the Resource Development Bureau:

A. Establish a loan committee to review the approval or denial recommendations for private loans.

B. Establish procedures for the program officer and bureau management to meet on a regularly scheduled basis to discuss loans which have overdue payments.

Chapter V
Coordination of Programs

Introduction

The Department of Natural Resources and Conservation (DNRC) requested the 1993 Legislature to combine the Water Development (WD) and Renewable Resource Development (RRD) Programs. The programs were administered as essentially one program for the past four bienniums. The goals of the programs were also essentially the same - to develop renewable natural resources for the people of Montana. The RRD Program concentrated on all renewable natural resources, and the WD Program dealt with only water. The combination of the two programs created the Renewable Resource Grant and Loan Program. The goal of the program is to enhance Montana's renewable resources through projects that measurably conserve, develop, manage, or preserve resources.

The Treasure State Endowment Program (TSEP) was created in 1992 to help local governments fund infrastructure problems. One of the goals of the program is to enhance the quality of life and protect the health, safety, and welfare of Montana citizens. The Department of Commerce (DOC) administers TSEP.

During our audit we found the WD and RRD Programs and TSEP provide grant funds for similar projects. All the programs fund water and sewer projects. Prior to the 1993 session, eight projects were considered for both WD and TSEP funding. This chapter illustrates how, despite administering loan and grant programs which have different purposes, increased coordination benefits DNRC and DOC when reviewing water and sewer projects proposed by municipal entities.

Treasure State Endowment Program

In June 1992 Montana voters passed an initiative to create the Treasure State Endowment Program (TSEP). Money for grants and loans was first appropriated in the 1993 Regular Legislative Session. The Community Development Bureau, Local Government Assistance Division, Department of Commerce, administers the program.

The purpose of TSEP is to assist local governments in funding public facility projects. Local governments include:

- -- Incorporated cities or towns.
- -- Counties.
- -- Consolidated local governments.
- -- County or multi-county water, sewer, or solid waste districts.

Types of Eligible Projects

Infrastructure projects eligible for funding include:

- -- Drinking water systems.
- -- Wastewater treatment.
- -- Sanitary sewer or storm sewer systems.
- -- Solid waste disposal and separation systems.
- -- Bridges.

State law requires projects to provide specific benefits. One such benefit is to enhance the quality of life and protect the health, safety, and welfare of Montana citizens. Other benefits include creating jobs for Montana residents and promoting economic growth in Montana by helping to finance the necessary infrastructure.

Funding Recommendations

State law (section 90-6-710(2), MCA) establishes preferences the department must follow when making recommendations for funding. The first preference is for projects which solve urgent and serious public health or safety problems. The second preference is for projects that enable local governments to meet state or federal health or safety standards.

Funding of Projects

Receipts from the Coal Severance Tax Bond Fund are deposited in the Treasure State Endowment Fund. Projects are then granted money from the Treasure State Endowment Fund. Financial assistance available under the program consists of: 1) matching grants for local infrastructure projects; 2) annual debt service subsidies on local infrastructure projects; and 3) loans from the proceeds of Coal Severance Tax bonds at a subsidized interest rate. The interest rate subsidies may be paid over the life of the loan or bonding period.

Comparison of Projects Funded Under the Programs

In comparing TSEP projects to WD and RRD projects, we found similarities in the types of projects funded. The following table illustrates the types of projects funded under the TSEP, WD, and RRD Programs.

Table 8

Types of Projects Funded

TSEP	WD	RRD
Drinking water systems	Drinking water systems	Solid waste recycling
Wastewater treatment	Wastewater treatment facilities	Public information
Storm sewer systems	Streambank stabilization	Forestry
Solid waste disposal	Public information	Soil surveys
Bridges	Recreation	Recreation
	Hydropower	
	Irrigation systems	
	Water storage	

Source: Compiled by the Office of the Legislative Auditor from DOC and DNRC records.

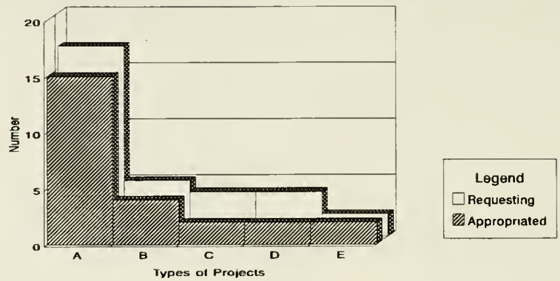
The following sections discuss types of projects funded, and amount of funding received by project type, for TSEP and WD and RRD Programs.

TSEP Project Applications and Funding

During the 1993 Legislative Session 32 entities applied for approximately $11.6 million of TSEP grants and engineering loans. The legislature appropriated grant and loan funds of approximately $4.1 million to 24 entities. The following graphs show number of applicants requesting and appropriated funds, and amounts requested and appropriated, by project type, for the 1993 Legislative Session.

Figure 2

Number of TSEP Applications Requesting and Appropriated Funds
(1993 Session)

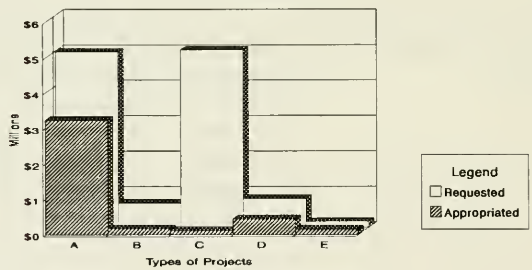


Projects
A - Water and Sewer
B - Engineering Loan
C - Bridge
D - Solid Waste
E - Storm Drain

Source: Compiled by the Office of the Legislative Auditor from department records end appropriation bills.

Figure 3

Dollar Amounts of Funding Requested and Appropriated for TSEP Applications
(1993 Session)



Projects
A - Water end Sewer
B - Engineering Loan
C - Bridge
D - Solid Waste
E - Storm Drain

Source: Compiled by the Office of the Legislative Auditor from department records and appropriation bills.

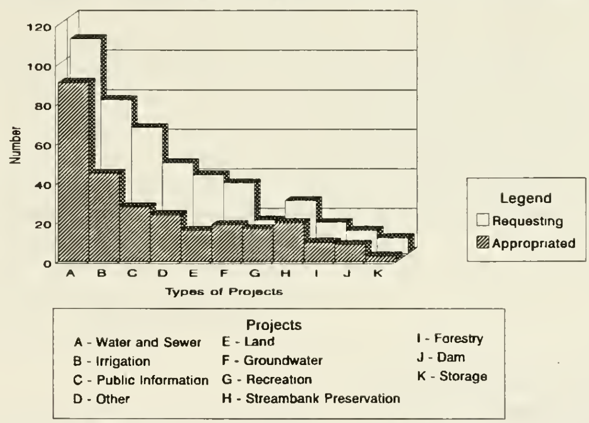
Of the 32 applications, 17 (53 percent) were submitted for water or sewer projects. Fifteen (88 percent) of the water or sewer projects were appropriated funding of $3.241 million. Engineering loans, bridges, and solid waste systems received the remaining $990,000 appropriation.

WD and RRD Applications and Funding

DNRC received a total of 465 applications, requesting approximately $52 million, for WD and RRD grant funding from the 1983 through 1993 sessions. The legislature appropriated approximately $23 million of grant funds to 282 projects. Figure 4 shows, by project type, number of applications submitted and number appropriated funds for the 1983 through 1993 Legislative Sessions. Figure 5 shows the amount of funding requested and appropriated.

Figure 4

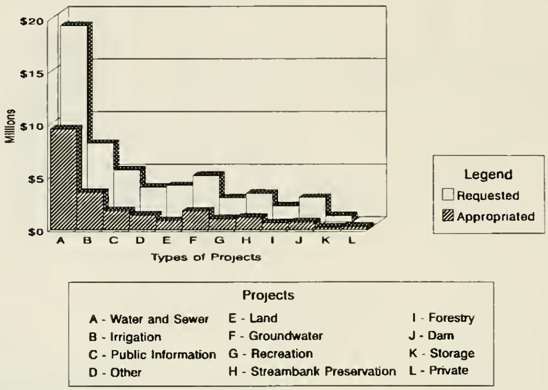
Number of WD and RRD Applications Requesting and Appropriated Funds
(1983 through 1993 Sessions)



Source: Compiled by the Office of the Legislative Auditor from department records and appropriation bills.

Figure 5

Dollar Amounts of Funding Requested and Appropriated for WD and RRD Applications (1983 through 1993 Sessions)



Private applicants were given direct appropriations in all years except 1983 and 1993.

Source: Compiled by the Office of the Legislative Auditor from department records and appropriation bills.

One hundred nine (approximately 25 percent) of the total WD and RRD grant applications were for water and sewer projects. Funds were appropriated for 91 (83 percent) of the total water and sewer project applications. Of the $18.7 million requested for water and sewer projects, the legislature appropriated approximately $9.6 million (41 percent).

Program Staff Coordinate

The above information indicates the programs administered by DNRC are similar to the program administered by DOC in that the programs receive applications for some of the same types of projects, i.e. water and sewer projects. During the 1993 Legislative Session, staff from both departments coordinated with each other when eight sponsors of water and sewer projects applied for both TSEP and WD funds. DNRC staff reviewed applications submitted to DOC by the sponsors who also applied to DNRC. DOC subcontracted with the private consultant used by

DNRC to complete technical reviews of water and sewer projects. Staff from both departments discussed which program would be the best source of funding to allow water and sewer projects to be completed.

Benefits of Coordination

Staff coordination of the Renewable Resource Grant and Loan Program and the Treasure State Endowment Program for water and sewer system applications provides efficiencies for both the applicants and the state. One form requesting financial information from municipal entities was created which provides the information needed by both agencies. The two departments submitted one Request for Proposal so one consultant will review water and sewer applications for both programs. Also, with coordination, only one determination is needed of debt structure and financial need of municipal entities.

Agency Action: Departments Coordinating Program Activities

The departments are coordinating the activities of the programs to ensure there is no duplication of effort. Since the programs have different missions, not all projects can be funded under both programs nor can all activities be coordinated. The RRG&L Program is directed toward conserving, developing, preserving, and managing natural resources. TSEP's current goal is to help fund infrastructure projects. But since some projects can receive funds from both programs, as is shown in table 8, the directors of the Department of Natural Resources and Conservation and the Department of Commerce are coordinating activities in areas common to both programs.

Chapter VI
Management Controls

Introduction

Management controls address overall operations of an organization including goals, objectives, policies, procedures, position descriptions, performance appraisals, and training. Management controls provide a measurement of progress, provide information to managers to evaluate performance, and provide a basis for staff to improve performance.

During our review of the Water Development and Renewable Resource Development Programs, administered by the Resource Development Bureau, Department of Natural Resources and Conservation (DNRC), we noted overall management controls could be improved. The following sections address the concerns we identified and our recommendations for improvement of the bureau's management controls.

Documented Goals and Objectives for the Program are Needed

The role of management entails directing the use of limited resources in the most efficient and effective manner to fulfill the statutory purposes of a program. Documenting relevant, measurable and verifiable goals and objectives is an important step in the process. Goals should relate to the purpose and mission of a program, correspond to the statutory intent of a program, and provide a clear direction for action. Specific goals give staff a clear understanding of a program's purpose and mission, and an understanding of the bureau's direction in relation to the program's statutory intent.

Objectives directly relate to a program's goals. Objectives should relate to program results or outcomes and not the internal process (i.e. procedures). Defined program objectives allow management to track the responsibilities and accomplishments within the bureau, and provide a method to measure program outcomes or results.

We found Resource Development Bureau goals and objectives for the Water Development and Renewable Resource Development Programs did not provide a direction for action. The goals and objectives merely documented what the legislature authorized. The goal established for the Water Development and

Renewable Resource Development Programs was a one line statement: "Water Development and Renewable Resource Development Program Administration." The objectives established to achieve the goal included: 1) ". . .to provide grants and loans on water related projects to public applicants." and 2) "Provide assistance to governmental entities through grants and loans for natural resource related projects." The bureau defined these objectives by documenting the number and amount of the grants and loans approved by the legislature during the 1993 biennium.

In addition to being aware of program achievements and outcomes, there is also the underlying requirement for a public program to be accountable. Measurable goals and objectives could provide the Resource Development Bureau with a method to help ensure the bureau meets the statutory purpose of the Renewable Resource Grant and Loan Program which is to ". . .enhance Montana's renewable resources through projects that measurably conserve, develop, manage, or preserve resources" (section 85-1-602(1), MCA).

House Bill 2 of the 1993 Special Legislative Session encouraged agencies to budget by performance and outcome measures. Documented measurable goals and objectives could help the bureau to measure the outcomes of the Renewable Resource Grant and Loan Program.

Recommendation #10

We recommend the Resource Development Bureau:

A. Develop clear, concise, measurable goals which relate to the purpose and mission of the Renewable Resource Grant and Loan Program.

B. Develop for each goal clearly identified objectives which relate to the assessment and function of the goal and relates to results or outcomes.

Documented Policies and Procedures are Needed

Formal documented policies and procedures guide personnel in performing duties in a consistent and accurate manner. Policies and procedures also strengthen management's control over operations and help assure continuity if staffing changes occur. Policies provide the framework for staff to determine what has to be accomplished, while procedures outline how staff should achieve the policy.

Policies and procedures must be clear, concise, and kept up-to-date. Out-of-date procedures can create misunderstandings of department intent and cause variation between what is supposed to take place with actual operations. A policy and procedures manual could provide guidance to staff, give staff access to organizational information, and encourage staff to be innovative in problem solving.

We found the Resource Development Bureau has limited formal policies and procedures. The bureau currently uses the following as policies and procedures.

-- A checklist for review of grant agreements.
-- A routing slip for processing and review of claims.
-- The appropriation bill and the legislative report for guidance to develop the scope of work.

-- The grant agreement which outlines requirements of project sponsors and the department's responsibilities.

In addition, the department has policies and procedures pertaining to working hours, equal employment opportunities, training, performance appraisals, and recruiting/hiring/promotion.

Staff informed us they did not have access to a procedural manual when they were first hired. They indicated they became familiar with job duties by trial and error or by review of old files. Staff said a program specific policy and procedure manual would be beneficial. Interviews with project sponsors confirmed this perception. Several project sponsors indicated the bureau has experienced a high level of turn-over, resulting in changes in requirements based upon staff's interpretation of the program's priorities.

Since there are no formal policies and procedures, most bureau staff developed procedural type manuals or plans specific to their individual duties and programs. Interviews with staff and observations of current manuals found most manuals developed by bureau staff are incomplete and outdated.

The following examples of formal written policies and procedures could be beneficial to the Renewable Resource Grant and Loan Program:

-- A policy for file documentation, with procedures outlining documentation and verification of receipt of application and fees, and documentation of all communication with project sponsors.

-- A policy for receipt and evaluation of final project reports, with procedures addressing review, cataloging, use and distribution of final project reports.

-- A policy requiring project sponsors to provide relevant project verification such as contract service agreements, and quarterly financial and progress reports, with procedures identifying when these are required, and instructions on how the project sponsors should complete the necessary reports.

-- A policy identifying the importance of site visits, with procedures addressing the types of projects which require these visits and the proper documentation of the visits.

Bureau and division management indicate it will be necessary to restructure the bureau in the near future to adjust for a reduction in work force. Policies and procedures could be helpful when making the transition.

In response to our recommendation, management indicated they will begin developing a policy and procedure manual for each program. The content of the manuals will be determined by program staff.

Recommendation #11

We recommend the Resource Development Bureau establish formal written policies and procedures.

Position Descriptions are Outdated

Accurate, complete position descriptions provide staff with clear guidelines of requirements and outline expectations essential for adequate performance. Position descriptions should define the scope, relationship, responsibilities, and authority of each position. Position descriptions should also accurately describe duties performed by each employee and qualifications should be clearly defined. When duties change, position descriptions should be reviewed and updated.

Interviews with staff, in conjunction with a review of existing position descriptions, found six of ten position descriptions are not current. Staff indicated they are aware their present position descriptions should be updated to reflect additional duties they presently perform. One staff person indicated 20 percent of his responsibilities are not included in the position description currently used to describe his duties. Two staff identified duties

outlined in their position descriptions as functions performed by other staff.

If position descriptions are not current it is difficult for management to ensure adequate distribution of duties. Also, management may not have accurate criteria for performance appraisals.

Resource Development Bureau management response to our recommendation indicated they are aware position descriptions should be updated.

Recommendation #12

We recommend the Resource Development Bureau rewrite staff position descriptions to ensure duties, responsibilities, and expectations of each position are current and accurate.

Annual Performance Appraisals Should be Implemented

Interviews with bureau staff and review of personnel files disclosed division and bureau staff do not receive annual performance appraisals. Of the eight staff within the Resource Development Bureau and one administrative support person, all employed for over a year, two staff received performance appraisals. One was completed nine years ago and the other ten years ago. We verified three division/bureau personnel received performance appraisal training from the Professional Development Center, Department of Administration, in 1989.

Montana law (section 2-18-101, MCA), Administrative Rules of Montana (2.21.6411, ARM), the Montana Operations Manual (3-0115, MOM), and department policy (#150) specify the need for annual performance appraisals. In addition, the department has developed written policies which state ". . .the appraisal cycle should be based on the state fiscal year. . .," and "All supervisors are required to conduct work planning and appraisal for each of their employees."

Performance appraisals provide clarification of the employee's role in the work place, and can provide an opportunity for improving efficiency, productivity, and job satisfaction. It is difficult for management to recognize outstanding performance or resolve unsatisfactory performance without appraisals. Without annual appraisals, there could also be a loss of effectiveness due to limited supervisory/employee communication.

Existing department policy appears to address the requirement for performance appraisals; however, division and bureau staff indicate performance appraisals have traditionally not been a priority of the department. The bureau agrees they should comply with department policy and state law. Bureau management indicates the department is currently reviewing the established performance appraisal policy, and as soon as a revised policy is developed, the bureau will implement the policy.

Recommendation #13

We recommend the Resource Development Bureau implement annual performance appraisals for staff in compliance with state law and department policy.

Bureau Should Organize Training Programs

A key component of personnel management is training. Training can improve or enhance an employee's ability to perform his/her job duties. Effective training programs can improve morale and encourage conscientious job performance.

The current department training policy, in conjunction with Montana Operations Manual, identifies the goals of a training program. Examples of these training goals are to:

-- Integrate employee's needs with assessment of training needs identified in the performance appraisal process.

-- Maintain and improve work performance.

-- Increase operating efficiency and service capability to meet the department's obligation to the public.

-- Provide opportunities for employees to improve individual work capabilities, job satisfaction, and confidence.

An evaluation process of the training program is also useful to determine need, usefulness, and quality of training received by staff.

Interviews with bureau staff indicated training is based upon: 1) individual requests when staff find training in which they are interested; and 2) availability of resources. The bureau has not established a training plan to identify staff needs or a method to locate needed training. Staff suggested additional training in grant administration and contract management could be beneficial to their job performance. Staff also indicated difficulties in finding relevant training.

Limited training assessments and planning could restrict efficiency of staff to complete assignments, potentially altering overall effectiveness of programs. For example, with the intended re-organization of the Resource Development Bureau and the re-distribution of staff duties, bureau management should evaluate staff's expertise and training needs. This evaluation could help ensure effective performance associated with additional, and possibly new, duties assigned. Without a training plan, and subsequent follow-up, management may find it difficult to determine if staff receive necessary training or if training received meets staff and program needs.

According to bureau management, training for the bureau is based upon budget availability, rather than an analysis of training needs. The bureau agrees additional training could improve staff's efficiency and intends to develop a more formal training plan in conjunction with annual performance appraisals. Bureau management also indicated budget constraints will continue to be factors in deciding whether or not training will be provided, and stated a specific curriculum for bureau staff may be cost

prohibitive. We believe the bureau could obtain information from other state agencies managing similar programs, such as Department of Commerce's Community Development Block Grant Program, to develop in-house grant/loan administration training.

Recommendation #14

We recommend the Resource Development Bureau follow established department policy concerning training of staff by:

A. Establishing training plans for staff.

B. Evaluating training received to determine if it meets the needs of the employee and the program.

Chapter VII Summary

Summary

This audit focused on the Water Development and Renewable Resource Development Programs. We examined DNRC's review of public grant and loan applications, project follow-up, review and follow-up of emergency grant applications, the Water Development Private Loan Program, and management controls in the Resource Development Bureau, which administers the programs.

We found the review of public grant and loan applications ensures projects are ranked based upon established criteria. We also found there is an established process for granting money for emergency projects. The bureau is generally in compliance with department policy concerning submission of required documentation from project sponsors. Interviews were completed with thirteen grant or loan recipients. We found project sponsors are generally pleased with the grant and loan program.

In our previous report (92P-37) we found the processes followed for ranking of projects, and compiling and disseminating information to the legislature are well-developed. During this audit we identified a concern pertaining to determining overall program effectiveness. There is limited follow-up of public entity grant and loan projects and private loan projects to ensure projects meet objectives required by state statute. Final reports of public grants and loans are not evaluated to determine if the project's proposed objectives were met or the project met the program objectives. We could not find documentation verifying private loan projects meet program objectives.

Implementing management controls could allow the bureau to verify it is meeting the intent of the program. Management controls which could be implemented include establishing goals and objectives which relate to program intent and measurable outcomes. Policies and procedures would allow staff to manage programs to meet the goals and objectives. Performance appraisals would provide staff feedback to ensure they are meeting the requirements of their jobs.

Chapter VII
Summary

The Renewable Resource Grant and Loan Program and the Treasure State Endowment Program both provide funds for water and sewer projects. Prior to the 1993 session, eight water and sewer project sponsors applied for funds under both programs. The two departments coordinated to determine the appropriate source of funding for each of the applications. This coordination has been developed even more for future sessions.

Agency Response

DEPARTMENT OF NATURAL RESOURCES
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RECEIVED
JUN - 7 1994

June 6, 1994

Scott A. Seacat
Office of the Legislative Auditor
Capitol Station

Dear Mr. Seacat:

We received the final draft of the "Water Development and Renewable Resource Development Programs Performance Audit Report" the week of May 23, 1994. The department's response is provided below. The comments are focused on the recommendations provided in the report.

Recommendation #/ Page #	
1/25	The department will prepare information for discussion with the Long Range Planning Sub-Committee. However, the department will not prepare recommendations until the Sub-Committee has had a chance to determine that a change is needed.
2/26	The department has already adopted this recommendations as discussed at the May 16th meeting.
3/30	A. An effort to improve documentation has already begun and will continue; B. The department will review the "Suggested Final Report Format" form and add wording that requires a discussion of project accomplishments; C. We currently review all final reports and only provide final payment upon acceptance of the report.
4/31	The final report documents are not publications that should be subject to deposit at the state library. The documents are contract monitoring reports. An effort to provide a data link to these files through the Natural Resource Information System will be made. If there are publications that are a product of a grant or loan, copies will be deposited at the state library.
5/42	The application guidelines represent the information that we have determined necessary to collect. As time allows, a document stating that these forms will be used and how will be developed.
6/45	The department has already stated the basis of waiving late fees and requiring late fees in an interim audit response. This language will be used to develop a written policy. Management will review the loan officer's decisions regarding late fees at loan committee meetings or in the form of a quarterly report. Prior approval will not be required.
7/48	The department will try to improve documentation.
8/49	The department will review the information provided in the Legislative Report, in this regard.

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9/52 A. As discussed at the May 16th meeting, the department has already formed the loan committee. B. Information is being provided to the bureau chief on a quarterly basis concerning loans with overdue payments from both the loan officer and program specialist.

10/63 The bureau will continue to provide the goals and objectives required by the budgeting process and over time will try to improve the measurable outcomes of these.

11/65 The bureau has written policies now. Over time, additional policies will be adopted. However, an extensive effort to develop policy and procedures manuals should not be expected soon.

12/66 The entire department is updating position descriptions and the resource development bureau will be updating position descriptions as directed by the personnel officer and department director.

13/67 The department is reviewing its policies on performance appraisals. When a final policy is developed for the department, the resource development bureau will implement it.

14/69 Bureau staff and management are encouraged to find effective training opportunities. As funding allows, staff members will attend these sessions. A formal training plan for staff will not be developed until after the next legislature since time and priorities do not allow.

Thank you for allowing the department to review and comment on the final report.

Sincerely,

Mark A. Simonich

Mark A. Simonich
Director

CC: Ray Beck